What we saw in 2020 and what we need to do in 2021 and beyond

Remarks by Himino Ryozo, Commissioner, Financial Services Agency (FSA) of Japan, at the Asian Financial Forum on January 18, 2021

I would like to provide a brief overview of what has happened so far and discuss what we need to do going forward in the regulatory policy area. And at the end, very briefly touch upon financial technologies and digitalization as well.

I think the post-Global Financial Crisis pre-COVID policy mix can be characterized as a combination of tight regulation and easy money. This combination has produced three things by the time of our entry into the COVID era, and they largely defined what we saw in financial markets in 2020.

Firstly, the post-GFC tight banking regulation created a resilient banking sector. It continued to support the economy in spite of severe stresses. Maybe this is the best part of the story.

Secondly, the combination of the tight banking regulation and easy money created an expanded non-bank financial sector. And I think it contributed to the liquidity panic in March 2020, which we could address only through extraordinary central bank operations, including the market-maker-of-last-resort type of operations. The Financial Stability Board (FSB), International Organization of Securities Commissions (IOSCO), and the Basel Committee on Banking Supervision are already looking at the lessons from the March event.1

Thirdly, the combination of easy money and the expanded non-bank financial sector made it possible to create a highly leveraged corporate sector in many parts of the world, in spite of the tight banking regulation. It hasn't resulted in major solvency stresses so far, but I think we owe it

---

[1] For example, see FSB (2020) *Holistic Review of the March Market Turmoil*, 17 November.

a lot to extraordinary fiscal policy measures (e.g. grants and guarantees), extraordinary monetary policy measures (e.g. asset purchases), and also extraordinary regulatory policies (e.g. payment deferrals). Some people say the jury is still out.

The question is what we need to do going forward in view of these. I believe we should preserve what we have attained by the post-GFC regulatory reforms: We should at least retain the best part of the story. But I think we should look at three things at the minimal.

Firstly, I think we should look at what didn't necessarily work as intended when the regulatory reform was designed. For example, we should look at the framework for non-bank financial sectors. We may also want to look at the supplementary leverage ratio for banks, which was designed to curb exuberance in good times, but may have worked as a constraint during the March 2020 liquidity panic. We may also want to review the designs of capital and liquidity buffers for banks so that they would work as real buffers, rather than as a de facto minimum.

Secondly, I think we may want to start thinking about how we can transit from the emergency policy phase to a post-COVID growth phase. We may want to think ahead how we can avoid undue cliff effects when we eventually exit from emergency measures. We may want to think about how we can alleviate the effects of debt overhang preventing strong recovery. In addition, we may want to accelerate our effort to make our regulatory framework more consistent with digital and green technologies, which could be the two main engines of the post-COVID growth.

I think we might also want to think about how we can enhance operational resilience of the whole financial system in view of the increase in pandemic, cyber, climate, and geopolitical risks. For example, if financial centers could complement with each other, the resilience of the whole system could be enhanced. And Japan intends to better contribute to the resilience and competitiveness of the whole Asian systems. The Japanese FSA has started to supervise new comer asset

managers in English. The government is planning to submit a bill to amend our inheritance tax law so that expatriates would need not say “Never die in Japan” going forward. The immigration rule will be made more friendly to professionals.

Lastly, let me briefly touch upon digitalization and financial technologies. I think the best potential of financial technologies lie not in replacing face-to-face and paper with digital and online, but in the accumulation, sharing, analysis, and utilization of data. And in order to attain this effectively, we need some level of common infrastructure. The infrastructure can be provided by the government, by private sector platform providers, or by decentralized architecture without a specific controlling center.

Each of the three got its strengths and weaknesses. I think we might want to start thinking about how we can best combine the role of the three actors going forward. This could be one of the key longer-term tasks for us in the coming period.